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In the

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 128

THE TEXAS AND PACIFIC RAILWAY COMPANY,

Petitioner,

versus

S. O. POTTORFF, Receiver of The First National Bank of El Paso, Texas,

Respondent.

BRIEF OF THE TEXAS AND PACIFIC RAILWAY COMPANY

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versus

S. O. POTTORFF, Receiver of The First National Bank of El Paso, Texas,

Respondent.

BRIEF OF THE TEXAS AND PACIFIC RAILWAY COMPANY

To the Honorable the Supreme Court of the United States:

Your petitioner's application for writ of certiorari to the Honorable Circuit Court of Appeals for the Fifth Circuit having been granted, this brief is filed pursuant to Rule 27.

Opinions in the Courts Below

The District Court did not write an opinion in the case. The opinion of the Circuit Court of Appeals is re-

ported in 63 Federal (2d) pages 1-5. The Circuit Court of Appeals on March 8, 1933, denied a petition for rehearing (R. 143), and your petitioner on June 6, 1933, filed its application for a writ of certiorari which this Honorable Court granted on October 9, 1933.

Grounds of Jurisdiction

(a) It is believed that the jurisdiction of this Honorable Court is sustained by section 347 of Title 28, United States Code (Judicial Code, section 240 as amended); also by *First National Bank v. Chicago T. & T. Co., 198 U. S. 280, 49 L. ed. 1051*, and *Texas & N. O. R. Co. v. Brotherhood Ry. & S. S. Clerks, 281 U. S. 548, 74 L. ed. 1034.*

(b) This case requires a construction of the National Bank Act of June 3, 1864 (Title 12, chap. 2, United States Code) and particularly that section of the Act providing that national banking associations organized thereunder "shall have power", inter alia,—

> "To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter" (12 U. S. C. A. §24, par. 7).

Specifically, this Honorable Court is requested to determine, among other things, whether or not (1) a solvent national bank, which has procured the account and deposits of a railroad company under an agreement to protect such account and deposits by corporate surety bonds, has the power to make a pledge of a portion of its assets in lieu of such bonds for the purpose of saving payment of premiums on the bonds and of retaining the account and deposits when one of the surety companies threatens withdrawal and a substitute surety can not be obtained; and (2) whether a receiver of that bank subsequently appointed by the Comptroller of the Currency may disaffirm such pledge agreement and retain both the pledged assets and the deposits although national bank examiners, who learned of the pledge agreement from the books of the bank one month before its failure, made no complaint of the transaction, and by their silence permitted the railway company thereafter to make substantial deposits upon the faith of the pledge agreement (R. 43-49, 88-95). The District Court by its judgment of May 26, 1932 (R. 39-42) and the Circuit Court of Appeals by its opinion and judgment of January 19, 1933 (R. 119-126) answered the first question negatively and the second question affirmatively, contrary, as your petitioner believes, to applicable decisions of this Honorable Court, and in a manner probably untenable or in conflict with the weight of authority.

Statement of the Case

The Texas and Pacific Railway Company is a corporation duly chartered and organized and now existing under and by virtue of the laws of the United States, to-wit: An Act of Congress entitled "An Act to incorporate the Texas Pacific Railroad Company, and to aid in the construction of its road, and for other purposes", approved March 3, 1871, and acts amendatory thereof and supplementary thereto, including an Act of Congress approved May 2, 1872, whereby, among other things, the name, style and title of said Texas and Pacific Railroad Company was changed to "The Texas and Pacific Railway Company" (R. 43, 88). Said railway company owns and operates in interstate and foreign commerce a line of railroad extending from New Orleans in the State of Louisiana to El Paso in the State of Texas over which a large volume of interstate traffic is constantly moving, and it is subject to all applicable provisions of the Interstate Commerce Act, as amended (R. 43-44, 88).

The defendant is the duly appointed, qualified and acting Receiver of The First National Bank of El Paso, Texas (R. 44).

The Texas and Pacific railway on July 3, 1922 was being operated by J. L. Lancaster and Charles L. Wallace, receivers appointed by the District Court of the

United States in and for the Western District of Louisiana, Monroe Division, and on that date, upon a petition filed by those receivers, an order was made and entered by that Court authorizing them to select The First National Bank of El Paso, Texas, as an additional depository for receivership funds. The order also recited that the bank "shall be required to furnish bonds with good and solvent sureties * * * in such an amount as will substantially equal the estimated average daily balances to be carried by said Receivers in said bank" (R. 44-45, 51-52, 88).

The First National Bank of El Paso, Texas, as principal, and National Surety Company, as surety, on or about July 10, 1922 executed and delivered to the receivers a surety bond for the sum of $25,000, conditioned as required by the Court's order, and thereupon the receivers opened an account with the bank and made deposits therein approximately in the amount of that surety bond (R. 45, 88).

The receivership of the Texas and Pacific railway was terminated on or about May 14, 1924, and upon the written request of the railway company, The First National Bank of El Paso, Texas, as principal, and National Surety Company, as surety, on or about August 7, 1924, executed and delivered to The Texas and Pacific Railway Company, and payable to it, a new surety bond for the sum of $25,000, conditioned in the same

manner as the old receivership bond, and guaranteeing that the bank,—

> "shall well and truly, on demand, pay over and deliver to The Texas and Pacific Railway Company, or its order, all and such sums of money, funds and valuables, general and special, as may now be on deposit by, in favor of, or in the name of The Texas and Pacific Railway Company with the said The First National Bank of El Paso, Texas, and as may be deposited hereafter by The Texas and Pacific Railway Company or by any one for its account, with the said The First National Bank of El Paso, Texas, or that may come into the custody or control of said The First National Bank of El Paso, Texas, for account of The Texas and Pacific Railway Company * * *" (R. 45, 54, 88).

The railway company's deposits with the bank increased during the month of April, 1927, and upon its written request, The First National Bank of El Paso, Texas, as principal, and Maryland Casualty Company, as surety, on or about April 25, 1927, executed and delivered to The Texas and Pacific Railway Company, and payable to it, an additional surety bond for the sum of $25,000, conditioned in the same manner as the bond next above quoted (R. 45-46, 55-56, 88).

During the month of January 1931, while the First National Bank was solvent and a going concern, its duly authorized active vice president-cashier called upon the

president of The Texas and Pacific Railway Company at Dallas, Texas, and requested him to accept as security for the railway company's deposits a pledge of United States Government Liberty Loan Bonds of the par value of $50,000 in lieu of the two $25,000 surety bonds. In explanation of this request, that bank officer stated that the First National desired to substitute the liberty bonds in order to relieve the bank of the premium payments on the surety bonds (R. 78-79, 89-90). Before making this trip to Dallas, the bank's vice president-cashier knew that the Maryland Casualty Company, surety on one of the $25,000 bonds, intended to "get off all bonds" of the First National Bank; that the bank was "going to have to give up this Maryland Casualty bond"; that the railway company was being asked to accept the liberty bonds in lieu of the surety bonds partly "because we knew eventually they (Maryland Casualty Company) would ask us to have the bond cancelled, or would not renew it"; and "I did not know when they withdrew we could not get any other surety company, any standard insurance company, to take that risk, but I had a good hunch". But this bank officer admitted that he "did not mention" to the railway company's president "at the time this substitution was made, or at any other time thereafter, this substitution was desired on account of the surety company threatening to cancel its bonds. He never heard of that, so far as I know" (R. 63, 70-72).

The railway president informed the vice president-cashier that it was the policy of the Texas and Pacific to require of depositories adequate security for its deposits, preferably corporate surety bonds; that the railway company would not continue its account with and make deposits in the First National Bank without security; that if the surety bonds were cancelled without the substitution of other adequate security the Texas and Pacific's account would be closed and its deposits withdrawn; but if the bank's officers and attorneys, after an investigation, concluded that the substitution of the liberty bonds in lieu of the surety bonds would be legal and valid in every particular, would constitute and be a binding and enforceable obligation against the bank, and would protect the railway company's deposits as fully and to the same extent as the surety bonds, the Texas and Pacific would agree to such substitution and to the cancellation of the surety bonds solely for the purpose of enabling the bank to save the bond premiums (R. 79-80, 90).

The bank's officer advised the president of the Texas and Pacific that the liberty bonds, when substituted for the corporate surety bonds, would protect the railway company's deposits as fully and to the same extent as they were then protected by corporate surety bonds and agreed to submit the proposed substitution

plan to the bank's attorneys for their investigation and approval (R. 90).

Thereafter, the vice president-cashier submitted the proposed substitution plan to the bank's attorneys, and after an investigation they advised the officers of the bank that the substitution could be legally made; that the pledge agreement would be an enforceable obligation against the bank; and that the substituted liberty bonds would protect the railway company's deposits as fully and to the same extent as the surety bonds. (R. 91).

At the request of the officers of the bank, its attorneys prepared a pledge agreement which was executed on January 29, 1931 in the regular course of the bank's business and while it was solvent by The First National Bank of El Paso, Texas, acting by and through F. M. Murchison, its president, and J. E. Benton, its cashier, which agreement recited in part:

> "For the purpose of securing the said Texas & Pacific Railway Company against any loss that might possibly occur by reason of its continuance and maintenance of the said deposit, The First National Bank of El Paso has on this date deposited in its Trust Department, and with its Trust Officer, which fact is evidenced by the signed statement to that effect of the said Trust Officer hereto attached, United States Government Liberty Bonds of the par value of Fifty Thousand ($50,000.00)

> Dollars, to be held by the said Trust Department, through its Trust Officer, in trust for the use and benefit of the said Texas & Pacific Railway Company. This is for the purpose of protecting it against loss as aforesaid, and it is agreed that the said Bonds shall, at all times, remain in the Trust Department as such security. * * *
>
> "Upon the closing of the said account, and only then, shall the said The First National Bank of El Paso have the right to withdraw the said securities from its Trust Department" (R. 91, 46-47, 57-58, 66).

Thereupon, the officers of the bank, while it was solvent and a going concern, with the full knowledge and approval of its board of directors, pursuant to said substitution agreement and in the regular course of the bank's business (R. 46, 66, 91), deposited in the Trust Department of the bank and with its Trust Officer, seven certain United States Government Fourth Liberty Loan 4-1/4 Coupon Bonds, 1933-38, of the aggregate amount and par value of $50,000, described by numbers and amounts as follows, to-wit:

G00129907	$ 5,000.00
A00115901	5,000.00
E00040105	5,000.00
K00129870	5,000.00
G00353057	10,000.00
H00353058	10,000.00
H 0029068	10,000.00.

The liberty bonds were so deposited with the Trust Officer separate and apart from all assets and securities of the bank and in a separate envelope bearing the name of The Texas and Pacific Railway Company, together with a copy of the pledge agreement and in accordance with the terms thereof (R. 46, 91-92); and the Trust Officer receipted for the bonds in the following language:

> "I, H. W. Moore, Trust Officer of the First National Bank of El Paso, hereby acknowledge receipt to the Trust Department of the said Bank of the Bonds above named and upon the conditions therein set forth" (R. 58-59).

All of those liberty bonds thereafter were held by said Trust Officer separate and apart from all assets and securities of The First National Bank of El Paso, Texas, and the liberty bonds for which the Texas and Pacific sued are the identical liberty bonds which were so deposited with the Trust Officer. A full record of this transaction was made upon the books of the bank on January 29, 1931, and those books ever since that date have reflected the same (R. 92).

The bank's vice president-cashier sent the executed pledge agreement to the president of the railway company at Dallas, Texas, and advised him that the officers and attorneys for the bank, after carefully investi-

gating the proposed substitution plan, had concluded that it would be in every respect a legal and binding obligation against the bank, that the pledge agreement had been prepared by the bank's attorneys, and that the bank's officers and attorneys were of the opinion and had declared that the executed pledge agreement and the liberty bonds, when substituted for the corporate surety bonds, would protect the deposits of The Texas and Pacific Railway Company in The First National Bank of El Paso, Texas, as fully and to the same extent as the corporate surety bonds (R. 92). Believing those representations to be true, the railway company's president accepted the executed pledge agreement and the liberty bonds, which had been placed in the custody of the bank's trust officer, in lieu of the then outstanding corporate surety bonds and caused the latter to be cancelled as of January 30, 1931 (R. 92-93). After the liberty bonds had been substituted for the surety bonds, The Texas and Pacific Railway Company, relying upon the pledge agreement and liberty bonds as security for its deposits, continued its account with and made deposits in The First National Bank of El Paso, Texas, and thereafter the railway company maintained in that bank an average daily deposit in excess of $50,000, the total par value of said liberty bonds; and the bank continued to accept and pay the railway company's checks and drafts drawn against its deposits until on

or about September 4, 1931, when the bank became insolvent, closed its doors to the public and refused to accept, honor or pay any other or further checks or drafts drawn by the railway company against its deposits (R. 47, 92-93, 63, 67, 81, 84-85).

The Texas and Pacific Railway Company deposited in the First National Bank during the period January 29, 1931 to August 5, 1931, a total of $132,220.27, and during the period August 6, 1931 to September 3, 1931, a total of $16,545.48. On the following dates it had on deposit the sums shown below, to-wit:

January 29, 1931	$22,264.10	
August 6, 1931	50,428.10	
September 3, 1931	54,646.94	(R. 93).

The First National Bank over a long period of years has furnished, often at its expense, corporate surety bonds to protect numerous deposits, both public and private, but apparently has not pledged its assets directly to private depositors for that purpose. By substituting the liberty bonds in lieu of the surety bonds as security for the railway company's deposits, the bank saved the premiums on the surety bonds, earned 4-1/4 per cent interest on the liberty bonds and was able to hold the railway company's account and deposits (R. 74, 94).

The Texas and Pacific Railway Company had $54,646.94 on deposit in the First National Bank on September 4, 1931, which sum of money it was entitled to receive from the bank upon demand. All of these funds, except accrued interest, were deposited by the railway company subsequent to January 29, 1931, the date on which the liberty bonds were substituted in lieu of the surety bonds as security for the Texas and Pacific's deposits, and all of those funds were collected by the railway company for common carrier services rendered in the transportation of both interstate and intrastate commerce (R. 48, 93).

The Comptroller of the Currency on or about September 6, 1931, duly and regularly appointed respondent S. O. Pottorff receiver of The First National Bank of El Paso, Texas, and on or about September 8, 1931, he took charge of the bank's affairs, assets and securities and its Trust Department in which the pledged liberty bonds were held as security for the railway company's deposits (R. 48, 88).[1]

National bank examiners acting under the supervision and control of the Comptroller of the Currency

[1] The receiver, pursuant to an agreement between the parties dated August 12, 1932 (R. 104), sold the liberty bonds for $52,273, which sum of money is being held by it "separate and apart from all assets" of The First National Bank of El Paso, Texas, "expressly subject to and for the purpose of satisfying any and all liens, claims or judgments which the Courts may adjudicate that The Texas and Pacific Railway Company has, or to which it may be entitled, in and to said liberty bonds, or the proceeds from the sale or sales thereof".

made an examination of the First National Bank commencing at 8 o'clock a. m. on August 6, 1931, and ending at noon on August 20, 1931, and their report to the Comptroller, covering the condition of the bank, forwarded after the bank closed, showed that liberty bonds of the par value of $50,000 were then pledged to secure the railway company's deposits (R. 94-95). They obtained this information from the books of the bank probably during the first two or three days of the examination. The officers of the bank were never notified or advised by either the bank examiners or the Comptroller of the Currency that the pledge of liberty bonds to secure the railway company's account was either irregular, illegal or beyond the powers of the bank, and no complaint of any character concerning the substitution agreement and the pledge of the liberty bonds was ever made to the bank's officers, or any of them, by the bank examiners or the Comptroller of the Currency (R. 94-95).

When the examination of the First National Bank began on August 6, 1931, the railway company had $50,428.10 on deposit, and between that date and September 3, 1931, the Texas and Pacific deposited an additional $16,545.48, relying upon the liberty bonds and the pledge agreement as security (R. 93-94).

The receiver allowed as a general claim only the Texas and Pacific's claim as a secured depositor for

the sum of $54,646.94, and tendered to the railway company a first dividend check for $16,394.08, being 30% of the full amount of its claim[1] (R. 94).

The Texas and Pacific Railway Company demanded of the receiver that he pay to it the sum of $54,646.94, which the receiver refused to do; the railway company then demanded that the receiver deliver to it the pledged liberty bonds and credit the company's claim with the market value of those bonds at the time of delivery, but this the receiver refused to do; and the railway company then demanded that the receiver sell the pledged liberty bonds and apply the proceeds of the sale to the liquidation of the company's claim, but the receiver refused to comply with this demand (R. 48-49, 88).

Thereupon, The Texas and Pacific Railway Company by its bill of complaint filed March 1, 1932, amended May 25, 1932, brought this action in the United States District Court for the Western District of Texas, El Paso Division, against S. O. Pottorff, Receiver of The First National Bank of El Paso, Texas, to recover of and from the receiver the liberty bonds pledged by the bank while solvent to secure the railway company's deposits, or to compel the receiver to sell those liberty bonds and deliver the proceeds of such sale to the railway company in partial settlement of its claim

1 Subsequent to the trial of this case the railway company, without prejudice to its rights, accepted the Comptroller's draft in the sum of $16,394.08 this reducing its claim as of September 4, 1931, to $38,252.86.

of $54,646.94 against the bank and its receiver; or, in the alternative, to compel the receiver to return to the railway company its deposits in the First National Bank as of September 4, 1931, or to recover of and from the receiver, as for money had and received, a sum of money equal to the railway company's deposits in the bank on that date (R. 1-20).

The receiver moved to dismiss the amended bill for want of equity and subsequent to that motion filed an answer alleging the invalidity of the pledge agreement. In addition, the receiver filed a cross-bill against the railway company seeking a judgment declaring the pledge agreement null and void, establishing the receiver's title to the liberty bonds and enjoining the railway company from asserting any rights thereto. To this cross-bill the Texas and Pacific filed a motion to dismiss for want of equity (R. 20, 21-27, 27-30, 31).

The trial court heard the case upon its merits and after argument overruled both motions to dismiss and rendered a decree on the cross-bill in favor of the receiver. From that decree the railway company prosecuted an appeal to the Circuit Court of Appeals for the Fifth Circuit, which Court on January 19, 1933, affirmed the decree of the trial court (R. 126) and on March 8, 1933, overruled the railway company's petition for a rehearing (R. 143).

Specifications of Error

The following specifications of error are based upon petitioner's assignments of error in the District Court (R. 108-113) and upon the errors assigned in its petition for rehearing in the Circuit Court of Appeals (R. 129-141).

I.

The Circuit Court of Appeals and the District Court erred in concluding and in holding as a matter of law that the bank's pledge of liberty bonds to secure the railway company's deposits was wholly void and of no effect.

II.

The Circuit Court of Appeals erred in its findings that the record is "devoid of affirmative proof that the thing the bank did here accords with national banking practices and customs, or is at all a necessary or desirable practice" (R. 120, 130).

III.

The Circuit Court of Appeals erred in its conclusions that the record does not "support the finding necessary to be made if the power is implied, that the giving of pledges for private deposits is a reasonable incident to the business of receiving deposits, and neces-

sary to the proper conduct of the business of a national bank" (R. 124, 131).

IV.

The Circuit Court of Appeals erred in its finding and conclusion that the record "shows that with the same uniformity which has attended the recognition of the power of national banks to secure public deposits by pledge, the Comptroller has ruled that they may not do so in the case of private deposits" (R. 120-131).

V.

The Circuit Court of Appeals erred in holding that "the judicial knowledge of banking practices and customs which we may take establishes" that the giving of pledges for private deposits is not a reasonable incident to the business of receiving deposits and is not necessary to the proper conduct of the business of a national bank; and the Court further erred in basing its decision adverse to appellant in part upon such judicial knowledge (R. 124, 132).

VI.

The Circuit Court of Appeals erred in its holding that "a deposit is one thing, a loan another", and in rejecting "the view that implied authority to pledge assets as security for loans extends to pledging them to secure deposits" (R. 123-124, 132).

VII.

The Circuit Court of Appeals erred in holding that "generally speaking a bank's general powers do not authorize it to pledge assets for deposits", that the contract for security "was invalid because of want of power in the bank", that "this bank had no such power * * * because no express power to do so has been conferred upon it by statute", and because the record does not "support the finding necessary to be made if the power is implied, that the giving of pledges for private deposits is a reasonable incident to the business of receiving deposits, and necessary to the proper conduct of the business of a national bank" (R. 124, 125, 132-133).

VIII.

The Circuit Court of Appeals placed too heavy a burden of proof upon the railway company and particularly erred in holding, in effect, that to sustain the bank's implied power to make the pledge agreement, petitioner must affirmatively prove that such agreement was "necessary to the proper conduct of the business of a national bank" and "accords with national banking practices and customs" (R. 120, 124, 133).

IX.

The Circuit Court of Appeals erred in holding that [illegible] company "was as fully charged with knowledge [illegible] the bank was" of the latter's "want of power" to make the contract for security (R. 125, 133).

X.

The Circuit Court of Appeals and the District Court erred in concluding and in holding as a matter of law that the receiver may disaffirm the pledge agreement without returning or tendering back to the railway company the full amount of its deposits.

XI.

The Circuit Court of Appeals erred in holding and in applying to this case its ruling that "It is settled law in the courts of the United States that what a corporation cannot bind itself to do, the courts will not compel * * *; Especially will it not do it in a case of this kind, where the controversy is not between the bank and the railway, but between the railway and the bank's creditors, the bank having failed, and 'the interest of others than the parties' * * * being involved" (R. 125, 135-136).

XII.

The Circuit Court of Appeals erred in holding in effect that the receiver, as a representative of the bank's

creditors, has rights or equities in and to the pledged liberty bonds different from and superior to those of the bank before the receivership (R. 125, 135).

XIII.

Having found that the pledge agreement was wholly void and of no effect, the Circuit Court of Appeals and the District Court erred in concluding and in holding as a matter of law that the railway company's deposits made subsequent to the pledge of the liberty bonds were general deposits the title to which passed to the bank, and were not special deposits the title to which remained and now is in The Texas and Pacific Railway Company.

XIV.

Having found that the pledge agreement was invalid, the Circuit Court of Appeals erred in holding in effect that the agreement of deposit in this case definitely fixed the character of the deposit as general (R. 124, 125, 136-137).

XV.

The Circuit Court of Appeals erred in holding that the contract of deposit contained two agreements, viz: "One that the bank should pay back to the railway upon demand the sums deposited with it as other general de-

posits were. * * * The other is an agreement for security" (R. 124, 137).

XVI.

The Circuit Court of Appeals erred in holding "there is no basis at all here for declaring a trust," and in further holding, in effect, that the railway company, being a "general depositor" in the bank, cannot, because its security failed through an invalidity which in law it knew, have the bank converted into a trustee and itself into a cestui que trust of the money of the bank to the extent of the amount of its general deposit (R. 125-126, 137).

XVII.

The Circuit Court of Appeals and the District Court erred in concluding and in holding as a matter of law that the railway company is not entitled to recover of and from the bank's receiver a sum equal to the full amount of its deposits, plus interest, as for money had and received.

XVIII.

The Circuit Court of Appeals erred in disregarding appellant's alternative plea for money had and received and in holding that this is not a suit "on the

benefits received", but is a suit "upon a contract, to enforce it" (R. 125, 138).

XIX.

The Circuit Court of Appeals erred in its conclusion that "this is not a case" like that "of a solvent bank which has obtained the benefit of a transaction, seeking to avoid, on the ground of ultra vires, returning what it has received" (R. 125, 134-135).

XX.

The Circuit Court of Appeals erred in holding in effect that the case at bar is one "not between the bank and the railway, but between the railway and the bank's creditors" (R. 125, 135).

Summary of Argument

Petitioner's argument is distributed under the following propositions, viz.:

1. A solvent national bank has the power to pledge, as security for deposits which it desires to procure or retain, a portion of its assets equivalent in amount to those deposits.

2. A solvent national bank, which has procured a railway company's deposits by furnishing at the bank's expense corporate surety bonds as security, has the power to pledge a portion of its assets, equivalent in amount to those deposits, in lieu of the surety bonds, for the purpose of saving bond premiums, and affording adequate security due to the threatened withdrawal of one of the surety companies for which a substitute surety company cannot be obtained.

3. A pledge by a solvent national bank of a portion of its assets as security for deposits which it desires to procure or retain is presumed to be valid, and this presumption will prevail in the absence of proof to the contrary.

4. The Receiver of The First National Bank of El Paso, Texas, has no power to question the validity of the pledge agreement.

5. The receiver of a national bank is estopped from asserting the want of power in that bank, while solvent, to pledge as security for deposits a portion of its assets, equivalent in amount to those deposits, in lieu of corporate surety bonds, which the bank furnished at its expense to procure such deposits, when the substitution was made for the purpose of saving bond premiums and affording adequate security due to the threatened withdrawal of one of the surety companies for which a substitute surety company could not be obtained, and when deposits have been made on the faith of the pledge agreement.

6. The receiver of a national bank is estopped from asserting the want of power in that bank, while solvent, to pledge as security for deposits a portion of its assets, equivalent in amount to those deposits, after national bank examiners, who learned of the pledge agreement from the books of the bank a month before its failure, made no complaint of the transaction and by their silence permitted the depositor to make further substantial deposits in reliance upon the pledge agreement.

7. When a solvent national bank induces a depositor to cancel and surrender corporate surety bonds protecting its deposits and to accept in lieu thereof other security which the bank is without authority to furnish, moneys thereafter deposited in reliance upon that security are received by the bank as special de-

posits which it holds in trust for the use and benefit of the depositor, and those deposits, or an equivalent sum of money, may be recovered in full from the bank or from its receiver into whose hands they passed upon the bank's failure.

8. When a solvent national bank induces a depositor to cancel and surrender corporate surety bonds protecting its deposits and to accept in lieu thereof other security which the bank is without authority to furnish, the courts will enforce an implied agreement on the part of the bank to return the moneys deposited with it in reliance upon the invalid security, and those deposits never become general assets of the bank which its subsequently appointed receiver may distribute ratably among the bank's unsecured creditors.

For convenience we have grouped for argument propositions 1, 2 and 3, infra pages 34-35, propositions 4, 5 and 6, infra pages 58-59, and propositions 7 and 8, infra page 75.

Under propositions 1, 2 and 3 petitioner argues that a solvent national bank has power to pledge a portion of its assets as security for deposits, either public or private, which it desires to procure or retain, and that it has power to pledge a portion of its assets as security for such deposits in lieu of corporate surety bonds, on which the bank pays the premiums,

for the purpose of saving those premiums and affording adequate security due to the threatened withdrawal of a surety company for which a substitute surety company cannot be obtained. Among other things it is shown:

(a) There is no statutory prohibition against solvent national banks pledging a portion of their assets to secure deposits.

(b) National banking associations are authorized in section 24 of the National Bank Act to exercise all such incidental powers as shall be necessary to carry on the business of banking, including that of receiving deposits.

(c) The incidental powers granted to national banks in section 24 of the National Bank Act are not restrictions upon but are additions to the express powers granted in that section.

(d) The word "necessary" as used in section 24 of the National Bank Act means "convenient" or "useful", and national banks may exercise such incidental powers as shall be convenient or useful in carrying on the business of banking, including that of receiving deposits.

(e) The pledge of liberty bonds in lieu of corporate surety bonds in the case at bar was both convenient

and useful to the First National Bank. By that substitution the bank saved the premiums on surety bonds, earned 4-1/4 per cent interest on the liberty bonds, was able to hold the railway company's account and deposits, and thereafter received from the railway company deposits totaling $148,765.75.

(f) This Honorable Court has held that national banks may pledge their assets as security for loans, also, that a deposit is a loan; therefore, those banks may pledge their assets as security for deposits.

(g) Text writers recognize the power of solvent national banks to pledge a portion of their assets as security for deposits which they wish to procure or retain.

(h) The United States Attorney General has held that the power to receive deposits is indispensable to the conduct of the business of banking; that the extent of its exercise is in a degree the measure of the success of banks; that national banks may give security for deposits and that the means of securing them are not limited or restricted by statute but rest in the discretion of the bank's officers and directors.

(i) The Honorable Circuit Court of Appeals for the Fourth Circuit has affirmed the power of solvent national banks to pledge portions of their assets as security for deposits, and has recognized their power

to substitute a pledge of assets in lieu of corporate surety bonds for the purpose of saving bond premiums.

(j) A substitution of a pledge of assets in lieu of corporate surety bonds for the purpose of saving bond premiums is a compromise arrangement for the benefit of the bank and is within its incidental powers.

(k) This Honorable Court has held that the provisions of the National Bank Act are not directed against all pledges whereby one creditor may obtain greater payment than another but against those given or arising after or in contemplation of insolvency; further, that liens, equities and rights arising by express agreement, or implied from the dealings between the parties, or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated. In the case at bar the pledge agreement was made while the bank was solvent and a going concern, and seven months before its failure.

(l) The Comptroller of the Currency has not ruled that national banks have no power to pledge their assets as security for deposits; on the contrary, national bank examiners appointed by the Comptroller, who learned of the pledge of liberty bonds in this case about one month before the bank failed, made no complaint to the officers of the bank and by their

silence permitted the railway company thereafter to make deposits totaling $16,545.48 in reliance upon the pledge agreement.

(m) The incidental powers conferred upon national banking associations by section 24 of the National Bank Act are not restricted to those acts or transactions which accord with national banking practices and customs; on the contrary, national banks are empowered to exercise all such incidental powers as shall be convenient or useful in carrying on the banking businesses specified in section 24, including that of receiving deposits.

(n) A party relying upon the power of a national bank to pledge a portion of its assets in lieu of corporate surety bonds as security for deposits need only prove that the pledge was made while the bank was solvent, that it was convenient or useful to the bank and in furtherance of the express power to receive deposits; when this showing has been made, as was done in the case at bar, the transaction, in the absence of proof to the contrary, is presumed to be valid.

The argument under propositions 4, 5 and 6 covers three principal points, namely:

(1) The Receiver of the First National Bank of El Paso, Texas, has no authority to question the validity

of the pledge agreement; he acquired no greater rights to or equities in the pledged liberty bonds than those possessed by that bank before its insolvency.

(2) The pledge of liberty bonds by the First National Bank was not an *ultra vires* act as those acts have been defined in decisions of this Honorable Court; in making the pledge the bank was carrying out an express power to receive deposits.

(3) The receiver is estopped from questioning the validity of the pledge agreement without returning or tendering to the railway company the deposits made by it in reliance upon that agreement as security, especially since national bank examiners, appointed by the Comptroller, learned of the pledge agreement one month before the bank failed but made no complaint to the bank's officers and by their silence permitted the railway company thereafter to make additional deposits totaling $16,545.48 in reliance upon that agreement.

Under propositions 7 and 8 petitioner contends that, if the pledge agreement be null and void, the bank received the railway company's deposits not as general but as special deposits, the title to which remained in the railway company; that those deposits passed to the receiver as a part of the so-called "as-

sets" of the bank; and that those assets are impressed with a trust in favor of the railway company to the extent of its deposits.

If this Honorable Court should hold, as did the Circuit Court of Appeals, that the amended bill of complaint sets forth only a cause of action upon the pledge agreement, and if this Court should hold that such agreement is *ultra vires* and void and may be disaffirmed by the receiver, petitioner asks that such action of the Court be without prejudice to another cause of action by petitioner against the receiver for money had and received or for the recovery of or compensation for the money with which petitioner parted on the faith of the pledge agreement.

ARGUMENT

First, Second and Third Propositions

1. A solvent national bank has the power to pledge, as security for deposits which it desires to procure or retain, a portion of its assets equivalent in amount to those deposits.

2. A solvent national bank, which has procured a railway company's deposits by furnishing at the bank's expense corporate surety bonds as security, has the power to pledge a portion of its assets, equivalent in amount to those deposits, in lieu of the surety bonds, for the purpose of saving bond premiums, and affording adequate security due to the threatened withdrawal of one of the surety companies for which a substitute surety company cannot be obtained.

New York County National Bank v. Massey, 192 U. S. 138, 145, 48 L. ed. 380, 383; Marine Bank v. Fulton County Bank, 69 U. S. 252, 17 L. ed. 785, 787; Auten v. United States National Bank of New York, 174 U. S. 125, 43 L. ed. 920, 926; Aldrich v. Chemical National Bank, 176 U. S. 618, 626, 44 L. ed. 611, 614; Wyman v. Wallace, 201 U. S. 230, 243, 50 L. ed. 738, 742; Jacksonville, Mayport, Pablo R. & Nav. Co. v. Hooper, 160 U. S. 514, 525, 40 L. ed. 515, 523; Ohio & M. R. Co. v. McCarthy, 96 U. S. 258, 24 L. ed. 693, 695-696; Union Pacific R. Co. v. Chicago, R. I. & P. R. Co., 163 U. S. 564, 581, 41 L. ed. 265, 271; Pittsburgh, C. &

St. L. R. Co. v. Keokuk & H. Bridge Co., 131 U. S. 371, 384-385, 33 L. ed. 157, 161-162; McCullough v. Maryland, 4 Wheaton 316, 412-414, 4 L. ed. 579, 603; First National Bank of Charlotte v. National Exchange Bank of Baltimore, 92 U. S. 122, 23 L. ed. 679, 681; Head v. The University, 86 U. S. 526, 22 L. ed. 160; Scott v. Armstrong, 146 U. S. 499, 510, 36 L. ed. 1059, 1063.

3. A pledge by a solvent national bank of a portion of its assets as security for deposits which it desires to procure or retain is presumed to be valid, and this presumption will prevail in the absence of proof to the contrary.

Ohio & M. R. Co. v. McCarthy, 96 U. S. 258, 24 L. ed. 693, 695-696; Union Pacific R. Co. v. Chicago, R. I. & P. R. Co., 163 U. S. 564, 41 L. ed. 265.

Argument Under First, Second and Third Propositions

The Honorable Circuit Court of Appeals for the Fifth Circuit has held that "generally speaking a bank's general powers do not authorize it to pledge assets for deposits" and that The First National Bank of El Paso, Texas, "had no such power" (R. 124). This conclusion was reached "not because the recognition of the power would conflict with our views of public policy" (R. 124), but because, as stated by the Court:

(1) "no express power to do so has been conferred upon it by statute" (R. 124);

(2) "no single other instance of the practice having been indulged in has been presented" (R. 120);

(3) the record "shows that with the same uniformity which has attended the recognition of the power of national banks to secure public deposits by pledge, the Comptroller has ruled that they may not do so in the case of private deposits" (R. 120);

(4) "a deposit is one thing, a loan another" and "the implied authority to pledge assets as security for loans" does not extend "to pledging them to secure deposits" (R. 123, 124);

(5) the record is "devoid of affirmative proof that the thing the bank did here accords with national banking practices and customs, or is at all a necessary or desirable practice" (R. 120);

(6) "the record does not support the finding necessary to be made if the power is implied, that the giving of pledges for private deposits is a reasonable incident to the business of receiving deposits, and necessary to the proper conduct of the business of a national bank" and "the judicial knowledge of banking practices and customs which we may take establishes the contrary to be true" (R. 124).

Thus we have a composite picture of the mind of the Circuit Court of Appeals on the question of power. But that Court made no effort to explain or define the language of section 24 of the National Bank Act which provides that a national banking association "shall have power * * * to exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; * * * by receiving deposits * * *". We momentarily defer a consideration of this language to dispose of certain propositions next above enumerated.

The Circuit Court of Appeals erred in finding (R. 120) that the record does not disclose a single other instance of a national bank pledging part of its assets to secure a deposit. The case of *Baltimore & Ohio Railway Company v. Smith, 56 Fed. (2d) 799,* is another instance, and the judgment of the District Court below was predicated upon the decision in that case (R. 34). *Illinois Central Railroad Company v. A. F. Rawlings, Receiver,* now pending before this Honorable Court on petition for writ of certiorari to the Honorable Circuit Court of Appeals for the Fifth Circuit, is another instance of a bank securing a deposit by a pledge of assets.

The Circuit Court of Appeals erred in finding that the record shows the Comptroller has uniformly ruled that national banks may not pledge part of their as-

sets to secure private deposits (R. 120). There is nothing in the record to warrant this finding; in fact the receiver offered no evidence upon the trial of the case (R. 88). To the contrary, the record does show that national bank examiners, appointed by the Comptroller, during an examination of the books of the First National Bank about one month before its failure, learned of the pledged liberty bonds, but they did not notify the officers of the First National Bank that the pledge agreement was either irregular, illegal or beyond the powers of the bank, and no complaint of any character concerning the substitution agreement and the pledge of the liberty bonds was ever made to the officers of the bank, or any of them, by those bank examiners or the Comptroller of the Currency (R. 94, 95). If, as stated by the Circuit Court of Appeals, the Comptroller has uniformly ruled that national banks may not pledge their assets to secure private deposits, it is strange indeed that the Comptroller's agents would be so derelict in their duties as to say nothing about such a "reprehensible" transaction when it came to their notice.

The Circuit Court of Appeals, following the Supreme Court of Arkansas in *McCown v. Edwards, 48 S. W. (2d) 558*, erroneously held that "a deposit is one thing, a loan another" and "the implied authority to pledge assets as security for loans" does not extend "to pledging them to secure deposits" (R. 123, 124). The rela-

tionship between a bank and its depositors often has been stated by this Honorable Court. Thus:

New York County National Bank v. Massey, 192 U. S. at page 145, 48 L. ed. p. 383 (quoting from Davis v. Elmira Savings Bank, 161 U. S. 275, 288):

> "'The deposit of money by a customer with his banker is one of loan, with the superadded obligation that the money is to be paid, when demanded, by a check' ".

Auten v. United States National Bank, 174 U. S. at pages 141-142, 43 L. ed. p. 926:

> "Banking in much, if not in the greater part of its practice, is in strict sense borrowing, and we may well hesitate to condemn it as illegitimate, or regard it as out of the course of regular business, and hence suspicious and questionable".

Marine Bank v. Fulton County Bank, 69 U. S. at page 256, 17 L. ed. 787:

> "All deposits made with bankers may be divided into two classes, namely: those in which the bank becomes bailee of the depositor, the title to the thing deposited remaining with the latter; and that other kind of deposit of money peculiar to banking business, in which the depositor, for his own convenience, parts with the title to his money and

> loans it to the banker; and the latter, in consideration of the loan of the money and the right to use it for his own profit, agrees to refund the same amount, or any part thereof on demand".

Furthermore, while recognizing that the power to borrow money "is not expressly given by the (national bank) act", this Honorable Court nevertheless has upheld pledges of assets to secure such loans because a national bank has the implied power "to incur liabilities in the regular course of its business," *Aldrich v. Chemical National Bank, 176 U. S. at page 626, 44 L. ed p. 614,* and because "it is not in terms prohibited by the National Banking Act," *Wyman v. Wallace, 201 U. S. at page 243, 50 L. ed. p. 742.* Since a deposit is a loan and a loan may be secured by a pledge of assets it follows that deposits may be so secured.

Morse on Banks and Banking (6 ed.), Vol. 1, §63, p. 182:

> "A bank may secure persons who loan it money by deposit * * *. Such a power is a mere incident of the right to receive deposits, which by necessary implication gives power to assign and mortgage negotiable instruments as security for them * * *".

Paton's Digest of Banking Law (1926), Vol. 1, §641:

> "Of course, a pledge of assets in contemplation of insolvency for the sake of creating a preference

> is avoided by Section 5242 of the Revised Statutes (Title 12, U. S. C. A. §91); but, in the absence of a preferential transfer in contemplation of insolvency, there is no federal statute under which a pledge of assets as security for a loan or deposit may be avoided."

The absence of express statutory power to pledge a part of its assets to secure deposits does not mean that national banks, while solvent, do not possess implied power so to do. Such implied power is clearly conferred by section 24 of the National Bank Act which provides that national banking associations "shall have power",—

> "To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter" (12 U. S. C. A. §24, par. 7).

After quoting the foregoing paragraph, this Honorable Court, in *First National Bank of Charlotte v. Na-*

tional Exchange Bank of Baltimore, 92 U. S. at page 127, 23 L. ed. p. 681, stated:

> "Authority is thus given to transact such a banking business as is specified, and all incidental powers necessary to carry it on are granted".

Congress having specifically declared that the receiving of deposits is a banking business, it follows that national banks may exercise all incidental powers necessary to receive deposits. We are thus brought to a definition of the word "necessary" as here employed.

It is perfectly plain that the Honorable Circuit Court of Appeals placed the strictest possible interpretation upon the word "necessary", evidently taking it for granted that the lawmakers used it as a synonym of the word "indispensable", but such was not their intention. As far back as *McCullough v. Maryland, 4 Wheaton 316, 412, 4 L. ed. 579, 603,* Chief Justice Marshall, in affirming the incidental power of the Federal Government to incorporate a national bank, placed a different interpretation upon a similar use of that word. We quote from that decision:

> "To its (the constitution's) enumeration of powers is added that of making 'all laws which shall be *necessary* and proper, for carrying into execution the foregoing powers, and all other powers vested by this constitution, in the Government of the

United States, or in any department thereof" (Wheat. pp. 412-13, L. ed. pp. 602-603).

* * * * *

"The argument on which most reliance is placed, is drawn from the peculiar language of this clause. Congress is not empowered by it to make all laws, which may have relation to the powers conferred on the government, but such only as may be '*necessary* and proper' for carrying them into execution. The word '*necessary*' is considered as controlling the whole sentence, and as limiting the right to pass laws for the execution of the granted powers, to such as are *indispensable*, and without which the power would be nugatory. That it excludes the choice of means, and leaves to Congress, in each case, that only which is most direct and simple.

"Is it true that this is the sense in which the word '*necessary*' is always used? Does it always import an absolute physical necessity, so strong that one thing, to which another may be termed necessary, cannot exist without that other? We think it does not. If reference be had to its use, in the common affairs of the world, or in approved authors, we find that it frequently imports no more than that one thing is *convenient*, or *useful*, or essential to another. To employ the means necessary to an end, is generally understood as employing any means calculated to produce the end, and not as being confined to those single means, without which the end would be entirely unattainable. Such is the character of human language, that no word conveys to the mind, in all situations, one single definite idea; and nothing is more common than to use words in a figurative sense. Almost all

> compositions contain words, which, taken in their rigorous sense, would convey a meaning different from that which is obviously intended. It is essential to just construction, that many words which import something excessive should be understood in a more mitigated sense—in that sense which common usage justifies. The word *'necessary'* is of this description" (our italics) (Wheat. pp. 412-414, L. ed. p. 603).

It should be presumed, at least in absence of proof to the contrary, that Congress in drafting section 24 of the National Bank Act, used the word "necessary" in its liberal sense and intended it to convey the meaning ascribed to it by this Honorable Court in *McCullough v. Maryland*, supra. Employing this definition and applying it to the foregoing quotation from *First National Bank of Charlotte v. National Exchange Bank of Baltimore*, we find that the power conferred upon national banks was two-fold: (1) "To transact such a business as is specified", i. e. the business of "receiving deposits"; and (2) "all such incidental powers necessary", i. e. convenient, useful, or essential, "to carry it on", i. e. the business of procuring deposits, and securing them, "are granted". It should be observed that the implied power thus granted, to use other language of Chief Justice Marshall, "is placed among the powers * * *, not among the limitations on those

powers. Its terms purport to enlarge, not to diminish the powers. It purports to be an additional power, not a restriction on those already granted" (4 Wheat. 419-420, 4 L. ed. 604-605). However, the Act requires those implied powers to be exercised "subject to law", which term this Honorable Court, in *Head v. The University, 86 U. S. at page 530, 22 L. ed. p. 160*, has defined to mean "subject to whatever law" the legislative body "might think fit to pass". But we find nothing in the National Bank Act prohibiting national banks, while solvent, from pledging a part of their assets to procure or retain deposits. We do find that Congress declared in section 52 of the Act of 1864 (12 U. S. C. A. §91) that,—

> "All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void * * *".

The plain implication of this statute is that transfers made before the commission of an act of insolvency and not in contemplation thereof shall be valid and enforceable,—such as the pledge of liberty bonds in the case at bar.

If a bank be solvent, there can be no valid objection to its giving in good faith a dollar security for a dollar gained by deposit, for the bank at any time can fully discharge all of its obligations. Hence it was that Congress limited its prohibition to transfers made by banks while insolvent or in contemplation thereof, fully understanding and intending that the quoted section would afford all the protection to which the bank's creditors should be entitled.

This interpretation of the Act is confirmed by the following statement of this Honorable Court in *Scott v. Armstrong, 146 U. S. at page 510, 36 L. ed. p. 1063:*

> "Undoubtedly any disposition by a National Bank, being insolvent or in contemplation of insolvency, of its choses in actions, securities or other assets, made to prevent their application to the payment of its circulating notes, or to prefer one creditor to another, is forbidden; but liens, equities or rights arising by express agreement, or implied from the nature of the dealings between the parties,

> or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated. The provisions of the Act are not directed against all liens, securities, pledges or equities, whereby one creditor may obtain a greater payment than another, but against those given or arising after or in contemplation of insolvency".

The pledge agreement in the case at bar was made for the benefit of the bank (R. 90, 94) in the regular course of its business (R. 66) and while it was solvent and a going concern (R. 46, 89, 91).

Attorney General T. W. Gregory, in an opinion furnished the Secretary of the Treasury on March 31, 1915, held that a national bank had the implied power to "enter into a contract with a guaranty company under which, in consideration of premiums paid by the bank, the company 'insures and guarantees each depositor in the bank the full payment of his deposit therein' " (30 Op. 341). In reaching this conclusion, the Attorney General said in part:

> "The law confers upon national banks such incidental powers as are required to meet all legitimate demands of the banking business and to enable them to conduct their affairs safely and prudently within the scope of their charters. (Sec. 5136, Rev. Stat.; First National Bank v. National Exchange Bank, 92 U. S. 122, 127.) The power to give security for deposits seems to be recognized by section

5153, Revised Statutes, as among these incidental powers. The section last mentioned, after providing that all associations created under the act shall, when so designated by the Secretary of the Treasury, be depositories, further provides that 'The Secretary of the Treasury shall require the associations thus designated to give satisfactory security, by the deposit of United States bonds and otherwise, for the safe-keeping and prompt payment of the public money deposited with them,' etc. It is believed that this section is more reasonably construed as a recognition of the existence of the power on the part of national banks to give security for deposits than as a grant by implication of authority to give security for Government deposits alone.

"The power of banks to give security for deposits or for payment of their debts has been frequently recognized. It has been held that the property of a bank may be pledged as security for a debt (United States v. Robertson (1831), 5 Pet. 611, 650); that a bond with sureties may be given to prevent depositors from withdrawing their accounts (Wylie v. Commercial & Farmers' Bank (1902), 41 S. E. 504, 509, 63 S. C. 406), and that a national bank may give its bond with sureties to secure a deposit of State funds (State of Nebraska v. First National Bank of Orleans (1898); 88 Fed. 947, 951.)

"The power to contract for guaranteeing or securing depositors arises from the nature of the relation existing between the banks and their depositors. The relation created between the bank and a depositor by the receipt of deposits is that of debtor and creditor. (Bank of the Republic v. Millard (1869); 10 Wall. 152, 155; Davis v. Elmira Savings Bank (1896), 161 U. S. 275, 288). The

power to receive deposits, expressly granted to every national bank (sec. 5136 R. S.), is, of course, indispensable to the conduct of the business of banking, and the extent of its exercise is in a degree the measure of the success of the bank. * * *

"The means by which depositors are to be protected and secured are not expressly limited or restricted by statute. A large discretion is left to the officers and directors. They may use such means for the purpose as are not prohibited by, or inconsistent with the provisions of, the law, and as they may reasonably find to be suitable and proper and not inconsistent with the prudent conduct of the affairs of the bank within the scope of its charter. * * *"

The Honorable Circuit Court of Appeals for the Fourth Circuit is of the same opinion. In *Burrowes v. Nimocks, 35 Fed. (2d) 152*, Circuit Judge Parker thus stated that case:

"This was a suit instituted by the receiver of the National Bank of Fayetteville, N. C., against the treasurer of Cumberland county, N. C., to determine the right to certain notes which had been transferred by the bank to the treasurer as security for the deposit of county funds" (p. 153).

In dealing with the receiver's contention that the vice president of the bank had no authority to secure the deposit, which the Court found to be in the nature

of a call loan and which the laws of North Carolina required to be secured, Judge Parker stated:

> "The vice president was expressly authorized to seek it (the deposit); and this authority carried by necessary implication the power to give the security necessary to obtain it" (p. 154).

While it is true that county funds were secured in the Nimocks case, the security was given prior to the 1930 amendment to the National Bank Act which specifically authorized national banks to give security for deposits of States and their political subdivisions in accordance with respective State laws, hence the question before the Court was one of implied power, under section 24 of the National Bank Act, to secure those funds, and the case therefore was essentially similar to the case at bar. Furthermore, there is no valid distinction between the giving of security for a public and a private deposit. As stated by Circuit Judge Parker in *Schumaker v. Eastern Bank & Trust Co., 52 Fed. (2d) 925:*

> "Whether a bank may pledge its assets for the security of an ordinary depositor is a question as to which there is conflict of authority. For cases denying such power, see Smith v. B. & O. R. Co. (D. C.), 48 F. (2d) 861; Divide County v. Baird, Receiver, 55 N. D. 45, 212 N. W. 236, 51 A. L. R. 296; Farmers' & Merchants' State Bank v. Consolidated School District, 174 Minn. 286, 219 N. W.

163, 65 A. L. R. 1407. For cases asserting it, see Ward v. Johnson, 95 Ill. 215; Ahl v. Rhoads, 84 Pa. 319; Cameron v. Christy, 286 Pa. 405, 133 A. 551; Richards v. Osceola Bank, 79 Iowa 707, 45 N. W. 294; McFerson v. National Surety Co., 72 Colo. 482, 212 P. 489; Ex Parte Grand Lodge, C. U. O. O. F. (State ex rel. Bradley v. People's Federation Bank), 147 S. C. 103, 144 S. E. 841; Williams v. Hall, 30 Ariz. 581, 249 P. 755; Grigsby v. People's Bank, 158 Tenn. 182, 11 S. W. (2d) 673. And as bearing on the question generally, see notes in 51 A. L. R. 313, and 65 A. L. R. 1412. Although some of the cases draw a distinction between a pledge of assets to secure a deposit of public funds and a pledge to secure a private deposit, there would seem to be, in the absence of statute, no valid basis for such distinction; * * *".

In determining whether or not the First National Bank had the implied power to substitute a pledge of assets in lieu of corporate surety bonds upon which it was paying premiums, this Honorable Court should have these facts in mind: Although admittedly solvent (R. 46, 89), it became necessary for the First National Bank to curtail expenses, including the premiums which it had been paying on the surety bonds protecting the railway company's deposits (R. 64). In addition, the Maryland Casualty Company, surety on one of those $25,000 bonds, had informed the officers of the bank that it was "going off" all bonds, and it was apparent

the bank would experience difficulty in procuring a substitute surety company (R. 70-72). The bank's officers knew that the railway company, with the cancellation of its bonds, would close its account and withdraw its deposits (R. 90), and this it wished to avoid. Being unware of the action of the Maryland Casualty Company (R. 72), the railway company, solely for the purpose of aiding the bank (R. 90), accepted the proffered pledge of liberty bonds, authorized the cancellation of its surety bonds (R. 92-93), continued its account with the First National Bank and thereafter deposited with it a total of $148,765.75 in reliance upon the pledge agreement (R. 93). The substitution of liberty bonds for corporate surety bonds was made in the regular course of the bank's business (R. 66) and while the bank was solvent and a going concern (R. 46, 89, 91). By this substitution the bank saved the premiums on the surety bonds, earned 4-1/4 per cent interest on the liberty bonds, and was able to hold the railway company's account and deposits (R. 94.)

It is clear that these facts bring this case within the rule announced by Judge Parker in *Burrowes v. Nimocks*, supra, namely, that the pledging of a bank's securities as protection for a deposit for the purpose of saving bond premiums is a reasonable exercise of the authority of a bank's vice president to procure such de-

posit [35 Fed. (2d) at page 154] and within the principle announced by this Honorable Court in *First National Bank of Charlotte v. National Exchange Bank of Baltimore, 92 U. S. 122, 23 L. ed. p. 679.* In that case it was held that the implied powers granted in section 24 of the National Bank Act "are such as are required to meet all the legitimate demands of the authorized business, and to enable a bank to conduct its affairs, within the general scope of its charter, safely and prudently". In this connection the Court said:

> "This necessarily implies the right of a bank to incur liabilities in the regular course of its business, as well as to become the creditor of others. Its own obligations must be met, and debts due to it collected or secured. The power to adopt reasonable and appropriate measures for these purposes is an incident to the power to incur the liability or become the creditor. Obligations may be assumed that result unfortunately. Loans or discounts may be made that cannot be met at maturity. Compromises, to avoid or reduce losses, are oftentimes the necessary results of this condition of things. These compromises come within the general scope of the powers committed to the Board of Directors and the officers and agents of the bank, and are submitted to their judgment and discretion, except to the extent that they are restrained by the charter or by-laws. Banks may do, in this behalf, whatever natural persons could do under like circumstances" (L. ed. p. 681).

What the bank did in the case at bar amounted to a compromise. It had procured the account and deposits of the railway company by furnishing corporate surety bonds on which it paid the premiums. These payments became burdensome and the bank wished to be relieved of them. At the same time the bank wished to retain the railway company's account and deposits which were beneficial to it. The bank's officers conceived the idea of effecting a compromise through the substitution of a pledge of a portion of the bank's assets in lieu of the surety bonds. By doing this the bank would be able to keep the railway company's account, which carried an average daily deposit balance of approximately $50,000, and at the same time save the bond premiums. This the bank clearly had authority to do.

We respectfully submit that these record facts clearly show that the pledging of assets in lieu of corporate surety bonds by the First National Bank was, contrary to the holding of the Circuit Court of Appeals (R. 121, 124), both "necessary" (as that word has been defined by this Honorable Court) and desirable, and that it was "a reasonable incident to the business of receiving deposits."

The National Bank Act does not require every act of a national bank to "accord with national banking practices and customs" before such act is legal. Neither does

it prohibit the doing of a certain act unless that act first is shown to be "necessary (that is, indispensable) to the proper conduct of the business of a national bank". Those banks are authorized to exercise all incidental powers which are convenient or useful (if not prohibited) in carrying on the business of banking, which includes the business of receiving deposits. A transaction, therefore, which comes within this implied power is valid even when performed for the first time by a national bank. And it is manifestly improper for the Courts, as was done in this case, to place a burden of proof upon petitioner greater than the Act itself required. If the railway company had any burden of proof it was merely to show, as it did, that the pledging of the bank's assets in lieu of corporate surety bonds was done at the special instance and request of the bank, in the regular course of its business, while the bank was a solvent and going concern, and several months before any question of the solvency of the bank arose, and that the pledging of the assets was convenient and useful to the bank, and resulted in a distinct advantage to it. Certainly these facts raised a presumption in favor of the validity of the pledge under the rule announced by this Honorable Court to the effect that corporations are presumed to contract within their powers, and, in the absence of proof to the contrary, their contracts are presumed to

be valid when not foreign to the purposes for which the corporation is created. *Ohio & M. R. Co. v. McCarthy, 96 U. S. at page 258, 24 L. ed. p. 695; Union Pac. R. Co. v. Chicago, R. I. & P. R. Co., 163 U. S. 564, 41 L. ed. 265.* Moreover, the pledge agreement being on its face valid, the receiver, who asserts that it was *ultra vires*, had the burden of proving its invalidity, *Clews v. Jamieson, 182 U. S. at page 490, 45 L. ed. p. 1197*, that is, that the thing the First National Bank did was not convenient or useful to it in carrying out its express power to receive deposits. But the receiver neither rebutted this presumption nor met this burden of proof; in fact he offered no evidence upon the trial of the case (R. 88).

As stated by Attorney General Gregory, "the power to receive deposits, expressly granted to every national bank * * * is indispensable to the conduct of banking, and the extent of its exercise is in a degree the measure of the success of the bank"[1]; and, as found by the Supreme Court of Tennessee in *Grigsby v. Peoples Bank, 158 Tenn. 193*, the practice of giving security for deposits "is a practice followed by many banks". Properly, therefore, it should be held that the means by which de-

1 Supra, pages 47-49.

posits are to be secured, not being limited or restricted by statute, should be left to the discretion of the bank's officers and directors who know best what is convenient or useful to it. Such holding is especially warranted by the facts of the case at bar which clearly bring it within the principle that "whatever may fairly be regarded as incidental to, or consequential upon those things which the Legislature has authorized, ought not, unless expressly prohibited, to be held, by judicial construction to be ultra vires". *Jacksonville, Mayport, Pablo R. & Nav. Co. v. Hooper, 160 U. S. 514, 523, 40 L. ed. p. 523.*

Fourth, Fifth and Sixth Propositions

4. The Receiver of The First National Bank of El Paso, Texas, has no power to question the validity of the pledge agreement.

Scott v. Armstrong, 146 U. S. 499, 510, 36 L. ed. 1059, 1063; Jones v. New York Guaranty & I. Co., 101 U. S. 622, 25 L. ed. 1030, 1035; Sioux City Terminal R. & Wareh. Co. v. Trust Co. of N. A., 173 U. S. 99, 110, 43 L. ed. 628, 632; Blair v. Chicago, 201 U. S. 400, 450, 50 L. ed. 801, 822; Case v. Terrell, 78 U. S. 199, 20 L. ed. 134; Thompson v. St. Nicholas National Bank, 146 U. S. 240, 36 L. ed. 956.

5. The receiver of a national bank is estopped from asserting the want of power in that bank, while solvent, to pledge as security for deposits a portion of its assets, equivalent in amount to those deposits, in lieu of corporate surety bonds, which the bank furnished at its expense to procure such deposits, when the substitution was made for the purpose of saving bond premiums and affording adequate security due to the threatened withdrawal of one of the surety companies for which a substitute surety company could not be obtained, and when deposits have been made on the faith of the pledge agreement.

Chicago, R. I. & P. Co. v. Howard, 74 U. S. 392, 19 L. ed. 117, 121; Zabriskie v. Cleveland, C. & C. R. Co., 64 U. S. 381, 16 L. ed. 488, 498.

6. The receiver of a national bank is estopped from asserting the want of power in that bank, while solvent, to pledge as security for deposits a portion of its assets, equivalent in amount to those deposits, after national bank examiners, who learned of the pledge agreement from the books of the bank a month before its failure, made no complaint of the transaction and by their silence permitted the depositor to make further substantial deposits in reliance upon the pledge agreement.

Brown v. Schleier, 118 Fed. 981, affirmed *194 U. S. 18, 48 L. ed. 857.*

Argument Under Fourth, Fifth and Sixth Propositions

The Honorable Circuit Court of Appeals held that the receiver may disaffirm the pledge agreement without returning or tendering to the railroad company its deposits made on the faith of that agreement. This holding apparently is on the theory that the receiver defends this action solely in his capacity as a trustee for creditors—not as a representative of the bank—and that as such trustee he has a greater right to or equity in the pledged liberty bonds than had the bank itself (R. 125).

The receiver's powers are enumerated in sections 191 and 192 of the National Bank Act. It is provided

in section 191 that the Comptroller, when satisfied of the insolvency of a national banking association, may appoint a receiver "who shall proceed to close up such association, and enforce the personal liability of the shareholders". In section 192 it is provided that the receiver,—

> "shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct; and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders".

The powers thus granted are not broad enough to authorize the receiver to challenge the validity of the pledge agreement which was executed by the bank and the railway company for the bank's benefit while it was solvent, and in furtherance of the bank's express power to receive deposits. Even in the case of *ultra vires* contracts this Honorable Court has held that no one but the sovereign is permitted to assert that a corporation's contract is *ultra vires*, unless by statute such person is authorized so to do. *Jones v. New York Guaranty & I. Co., 101 U. S. 622, 25 L. ed. 1030, 1035; Sioux City Terminal R. & Wareh. Co. v. Trust Co. of N. A., 173 U. S. at page 110, 43 L. ed. 632; Thompson v. St. Nicholas*

National Bank, 146 U. S. at page 251, 36 L. ed. 961; Blair v. Chicago, 201 U. S. at page 451, 50 L. ed. 822. The statutory power to question the validity of the pledge agreement is lacking, and the receiver "does not in any sense represent the government". *Case v. Terrell, 78 U. S. 199, 20 L. ed. 134, 135.*

It may be contended that the receiver, as a representative of the bank, can question the validity of the pledge agreement, but if so, he must first return or tender to the railway company its deposits made in reliance upon that agreement, as the bank would be required to do.

But it will be urged that the receiver, as a representative of the bank's creditors, may disaffirm the pledge agreement. It should be remembered that the liberty bonds, at the bank's suggestion, were pledged in lieu of surety bonds (R. 89, 91) for the benefit of the bank (R. 90, 94), in the regular course of its business (R. 66) and while it was solvent and a going concern (R. 46, 89). The transaction took place on January 29, 1931, some seven months before the bank became insolvent, and a full record thereof since that date has been carried on the bank's books (R. 92). Moreover, the creditors now represented by the receiver are those whose deposits no doubt were made since the bonds were pledged. Under these circumstances it is difficult to understand how those creditors or their rep-

resentative, the receiver, acquired any special property interest in the pledged bonds superior to that of the bank itself, and especially so since the railway company thereafter deposited a total of $148,765.75 relying on the pledge agreement, of which sum more than $54,000 on deposit when the bank failed would be distributed by the receiver to those creditors upon delivery of the pledged bonds to the railway company. But the receiver acquired no greater right in the pledged bonds than the bank had. This is made clear by at least two decisions of this Honorable Court. In *Scott v. Armstrong, 146 U. S. at page 507, 36 L. ed. p. 1062*, Chief Justice Fuller, speaking for the Court, held:

> "The receiver took the assets of the Fidelity Bank as a mere trustee for creditors, and not for value and without notice and, in the absence of statute to the contrary, subject to all claims and defenses that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached."

And again, in *Fourth Street National Bank v. Yardley, 165 U. S. at page 653, 41 L. ed. p. 863*, this Court stated:

> "The receiver took no greater rights in the property of the insolvent bank which came into his possession than that which the insolvent bank possessed."

This being true, the receiver could not disaffirm the pledge agreement without returning or tendering to the railway company the full amount of its deposits made on the faith of that agreement unless the bank could have done so. The real question, therefore, is: Could the First National Bank have disaffirmed the agreement without returning the deposits?

In answering this question affirmatively, the Circuit Court of Appeals relied upon *California Nat. Bank v. Kennedy, 167 U. S. 362, Union Pac. Ry. v. Chicago, 163 U. S. 564,* and *Central Transportation Co. v. Pullman Car Co., 139 U. S. 60* (R. 125). In those cases the Court was dealing with contracts which were, to use the language of Mr. Justice Gray in the Pullman Car case, "ultra vires in the proper sense, that is to say, outside the object of its (the corporation's) creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature" (139 U. S. 59, 35 L. ed. 68). For example: In *Central Transportation Co. v. Pullman's Palace Car Co., 139 U. S. 24, 35 L. ed. p. 55,* the leading case, this Honorable Court was called upon to determine the validity of a 99-year lease and Mr. Justice Gray stated:

> "The plaintiff not only parts with all its means of carrying on the business, and of performing the duty, for which it had been chartered, * * * but it undertakes to transfer, for ninety-nine years,

> nearly co-extensive with the duration of its own corporate existence, the whole conduct of its business, and the performance of all its public duties, to another corporation * * *."
>
> "Considering the long term of the indenture, * * * the frank avowal in the indenture itself, of the intention of the two corporations to prevent competition and to create a monopoly, there can be no doubt that * * * the real purpose of the transactions was, under the guise of a lease of personal property, to transfer to the defendant nearly the whole corporate franchise of the plaintiff * * *" (U. S. pp. 52-53; L. ed. p. 66).

It is not surprising, therefore, that the Court in that case found: "The necessary conclusion from these premises is, that the contract sued on was unlawful and void, because it was beyond the powers conferred upon the plaintiff by the legislature * * *" (U. S. p. 53, L. ed. p. 66); or that plaintiff's plea of estoppel met with this positive denial by the Supreme Court:

> "It was argued in behalf of the plaintiff that, even if the contract sued on was void, because ultra vires and against public policy, yet that, having been fully performed on the part of the plaintiff, and the benefits of it received by the defendant, for the period covered by the declaration, the defendant was estopped to set up the invalidity of the contract as a defense to this action to recover the compensation agreed on for that period.

> "But this argument, though sustained by decisions in some of the states, finds no support in the judgments of this court" (U. S. pp. 54-55, L. ed. p. 67).

In *California Nat. Bank v. Kennedy, 167 U. S. 362, 42 L. ed. 198*, the Supreme Court was considering the power of the California National Bank to acquire 990 shares of stock of the California Savings Bank, and the resultant liability of the former as a shareholder of the latter which had become insolvent. The questions before the Court were thus stated by Mr. Justice White:

> "1st, Do the statutes of the United States (U. S. Rev. Stat. §5136 et seq.) relating to the organization and powers of national banks prohibit them from purchasing or subscribing to the stock of another corporation? And, 2nd, If a national bank does not possess such power, can the want of authority be urged by the bank to defeat an attempt to enforce against it the liability of a stockholder?" (U. S. p. 366, L. ed. p. 200).

After holding that "the United States statutes relative to national banks constitute the measure of the authority of such corporations, and that they cannot rightfully exercise any powers except those expressly granted or which are incidental to carrying on the business for which they are established" this Court found that "a national bank does not possess the power to deal in

stocks" because "the prohibition is implied from the failure to grant the power" (167 U. S. 366-367, 42 L. ed. 200). In this connection it should be noted that section 24 of the National Bank Act (12 U. S. C. A. Title 12, chap. 2) does not authorize the dealing in stocks, but limits national banks to the transaction of the business of banking "by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes * * *". Hence the Court's holding that the failure to grant the power was an implied prohibition against its exercise. The Court also observed:

> "On behalf of the plaintiff below it was admitted at the trial that the stock of the savings bank was not 'taken as security or anything of the kind', and it is not disputed in the argument at bar that the transaction by which this stock was placed in the name of the bank was one not in the course of the business of banking for which the bank was organized" (U. S. p. 367, L. ed. p. 200).

Having found that dealing in stock was "entirely outside of the powers conferred upon the bank, and was in nowise the transaction of banking business or incidental to the exercise of the powers conferred upon the bank" (U. S. p. 370, L. ed. p. 201), the Court concluded

that the California National Bank was not estopped, by accepting stock dividends, from asserting its want of authority to purchase the stock in defense of an action against it as a shareholder. But the Court expressly stated that these facts distinguished the case from such cases as *National Bank v. Whitney, 103 U. S. 99, 26 L. ed. 443*, and *Union National Bank v. Matthews, 96 U. S. 621, 25 L. ed. 188* (U. S. p. 370, 371, L. ed. p. 201).

In the Whitney case, the Court, basing its decision on the Matthews case, upheld the power of a national bank to accept real estate security for future advancements to the mortgagor, although the National Bank Act only authorized the loaning of money on personal security, and the holding of real estate as security for debts previously contracted. In the Matthews case, the Court upheld the power of a national bank to accept as security for a contemporaneous loan a mortgage upon real property, and held that the borrower could not defend an action for foreclosure, upon non-payment of his note, by asserting the bank's want of power to accept the mortgage security. In the latter case this was said:

> "As the transaction is disclosed in the record, the loan was made upon the note as well as the deed of trust. * * * The deed, as a mortgage would have been, was an incident to the note * * *.
>
> "The intent, not the letter of the statute, constitutes the law. A court of equity is always re-

luctant in the last degree to make a decree which will effect a forfeiture. The Bank parted with its money in good faith. Its garments are unspotted. Under these circumstances, the defense of ultra vires, if it can be made, does not address itself favorably to the mind of the Chancellor.".

* * * *

"The statute does not declare such a security void. It is silent upon the subject. If Congress so meant, it would have been easy to say so; and it is hardly to be believed that this would not have been done, instead of leaving the question to be settled by the uncertain result of litigation and judicial decision" (25 L. ed. 189).

* * * *

"Where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign alone can object. It is valid until assailed in a direct proceeding instituted for that purpose."

* * * *

"Sedg. Stat. and Const. Constr., 73, says: 'Where it is a simple question of authority to contract, arising either on a question of regularity of organization or of power conferred by the charter, a party who has had the benefit of the agreement cannot be permitted in an action founded upon it to question its validity. It would be in the highest degree inequitable and unjust to permit a defendant to repudiate a contract, the benefit of which he retains' " (25 L. ed. 190).

In *Union P. R. Co. v. Chicago, R. I. & P. R. Co., 163 U. S. 564, 41 L. ed. 265*, this Honorable Court upheld the power of a railroad company to grant trackage rights to another railroad company in the City of St. Louis. The following pertinent statements are extracted from the Court's opinion:

> "The general rule is that a contract by which a railroad company renders itself incapable of performing its duties to the public or attempts to absolve itself from those obligations without the consent of the state, or a contract made by a corporation beyond the scope of its powers, express or implied, on a proper construction of its charter, cannot be enforced or rendered enforceable by the application of the doctrine of estoppel. Thomas v. West Jersey R. Co., 101 U. S. 71 (25:950); Central Transp. Co. v. Pullman's Palace Car Co., 139 U. S. 24 (35: 55).
>
> "But where the subject matter of the contract is not foreign to the purposes for which the corporation is created, a contract embracing 'whatever may fairly be regarded as incidental to, or consequential upon, those things which the legislature has authorized, ought not, unless expressly prohibited, to be held by judicial construction to be ultra vires'. Jacksonville, M. P. R. & Nav. Co. v. Hooper, 160 U. S. 514, 525 (40: 515, 523); Atty. Gen. v. Great Eastern R. Co., L. R. 5 App. Cas. 473, 478; Brown v. Winnisimmet Co., 11 Allen, 326, 334" (163 U. S. p. 581-82; 41 L. ed. 271).

* * * *

"We think that it would be carrying the doctrine of *ultra vires* much too far to deny absolutely the competency of a railroad company, being a public highway, whose use is common to all citizens, to contract to give another running rights over its tracks without express statutory authority; and that under proper circumstances such a contract may well be held within its implied powers" (163 U. S. p. 585; 41 L. ed. 273).

* * * *

"The leading cases of Thomas v. West Jersey R. Co., 101 U. S. 71. (25:950); Pennsylvania R. Co. v. St. Louis, A. & T. H. R. Co., 118 U. S. 290 (30: 83); Oregon R. & Nav. Co. v. Oregonian R. Co., 130 U. S. 1 (32:837); Central Transp. Co. v. Pullman Palace Car Co., 139 U. S. 24 (35:55); St. Louis, V. & T. H. R. Co. v. Terre Haute & I. R. Co., 145 U. S. 393 (36:748); United States v. Union P. R. Co., 160 U. S. 1 (40:319), arose upon instruments which dispossessed the corporations of all of their property and of all capacity to perform their public duties. But we have no such case here" (163 U. S. 590; 41 L. ed. 274).

* * * *

"We do not feel called upon to enter at length upon other objections urged by appellants' counsel. One of them was that the Rock Island and St. Paul companies derived no power from the laws of Nebraska to enter into the alleged contract because they had not complied with the statutes of the state in that behalf. * * * The Rock Island Company built its road from South Omaha to Lincoln as vested with the corporate power to do so, and it contracted as in the possession of the

power as a corporation existing in and under the laws of Nebraska. The state appears to have been content, and the contract, not being necessarily beyond the scope of the powers of the corporation, must, in the absence of proof to the contrary, be deemed valid" (163 U. S. 591-92; 41 L. ed. 275).

* * * *

"* * * Courts may be permitted, where there is no legislative prohibition shown, to put a favorable construction upon such exercise of power by railroad companies as is necessary to promote the success of the company within its chartered powers * * *" (163 U. S. 594; 41 L. ed. 276).

The two following cases should be added to those cited in the foregoing opinion:

Ohio & M. R. Co. v. McCarthy, 96 U. S. at page 258, 24 L. ed. p. 695:

"* * * When a contract is not on its face necessarily beyond the scope of the power of the corporation by which it was made, it will, in the absence of proof to the contrary, be presumed to be valid. Corporations are presumed to contract within their powers. The doctrine of ultra vires, when invoked for or against a corporation, should not be allowed to prevail where it would defeat the ends of justice or work a legal wrong * * *."

Chicago, R. I. & P. Co. v. Howard, 74 U. S. at page 392, 19 L. ed. p. 121:

"Corporations as much as individuals are bound to good faith and fair dealing, and the rule is well

settled that they cannot, by their acts, representations or silence, involve others in onerous engagements and then turn round and disavow their acts and defeat the just expectations which their own conduct has superinduced".

This Honorable Court will perceive the distinction between the Pullman Car and California National Bank cases, cited by the Circuit Court of Appeals, and the case at bar. As stated by this Court in *Union P. R. Co. v. Chicago, R. I. & P. R. Co.*, supra, the contract in the Pullman Car case "dispossessed the corporation of all of its property and of all capacity to perform its public duties (163 U. S. 590, 41 L. ed. 274). In the California case, the purchase of stock in the savings bank was "entirely outside of the powers conferred upon the bank, and was in nowise the transaction of banking business or incidental to the exercise of the powers conferred upon the bank" (167 U. S. 370, 42 L. ed. 201). In the case now before the Court the pledge was made in carrying out the power expressly conferred to do a banking business by receiving deposits. We do not find any case by this Honorable Court which holds that a party enjoying the benefits of this character of contract may escape his just responsibilities by a plea of ultra vires, or that such defense will not be rendered nugatory by the law of estoppel.

There is another cogent reason for holding that the receiver cannot disaffirm the pledge agreement without returning or tendering to the railway company the full amount of its deposits. National bank examiners acting under the supervision and control of the Comptroller of the Currency made an examination of the First National Bank commencing on August 6, 1931. A day or so later they learned from the bank's books that liberty bonds of the par value of $50,000 were pledged to secure the Texas and Pacific's deposits, but none of the bank's officers were notified or advised by either the bank examiners or the Comptroller that the pledge of bonds was either irregular, illegal or beyond the powers of the bank (R. 94-95). If the Comptroller and his agents, the bank examiners, thought the pledge of bonds an ultra vires act, certainly it was their duty at once to so advise the bank's officers and to require that other valid security be given the railway company and the pledge agreement cancelled. Had this been done, the Texas and Pacific's deposits could have been secured in a manner satisfactory to the Comptroller, or its deposits could have been withdrawn. Surely it cannot be that one agent of the Comptroller, the receiver, will be permitted to disaffirm an agreement which impliedly

has been sanctioned by other agents of the Comptroller, the bank examiners, after the other contracting party has acted upon that assurance to his detriment. This extract from the opinion in *Brown v. Schleier, 118 Fed. 981*, affirmed *194 U. S. 18, 48 L. ed. 857*, is pertinent:

> "We think that, in virtue of his office as receiver, he is not authorized to challenge or impeach an executed transaction between the bank and a third party, that was simply ultra vires, and which, though known to the United States, through its proper officials, at the time it was undertaken and consummated, was neither arrested nor complained of by the United States or any creditor or stockholder of the bank."

When the receiver took charge of the First National Bank the pledge agreement had been performed by all parties except the bank's trust officer who held the liberty bonds as a trustee for the railway company. The bank had made the pledge and the Texas and Pacific had made the deposits; nothing remained to be done except the delivery by the trustee to the railway company of the liberty bonds to which it has shown itself justly entitled.

Seventh and Eighth Propositions

7. When a solvent national bank induces a depositor to cancel and surrender corporate surety bonds protecting its deposits and to accept in lieu thereof other security which the bank is without authority to furnish, moneys thereafter deposited in reliance upon that security are received by the bank as special deposits which it holds in trust for the use and benefit of the depositor, and those deposits, or an equivalent sum of money, may be recovered in full from the bank or from its receiver into whose hands they passed upon the bank's failure.

8. When a solvent national bank induces a depositor to cancel and surrender corporate surety bonds protecting its deposits and to accept in lieu thereof other security which the bank is without authority to furnish, the courts will enforce an implied agreement on the part of the bank to return the moneys deposited with it in reliance upon the invalid security, and those deposits never become general assets of the bank which its subsequently appointed receiver may distribute ratably among the bank's unsecured creditors.

Scott v. Armstrong, 146 U. S. 499, 507, 510, 36 L. ed. 1062-1063; Central Transportation Co. v. Pullman Car Co., 139 U. S. 24, 60, 35 L. ed. 55, 69; Aldrich v. Chemical National Bank, 176 U. S. 618, 636, 44 L. ed

611, 618; Citizens' National Bank v. Appleton, 216 U. S. 196, 206, 54 L. ed. 443, 446.

Argument Under Seventh and Eighth Propositions

The Circuit Court of Appeals has held that this is not a suit for benefits received, but one "upon a contract, to enforce it" (R. 125).

The amended bill of complaint (R. 1-20) substantially sets forth the matters incorporated in the foregoing statement of facts and contains an alternative plea to the effect that the railway company is entitled to recover from the receiver, as for money had and received, the full amount of its deposits in the First National Bank when it failed on September 4, 1931, if it is held that the pledge agreement is unenforceable (R. 10), and an alternative prayer for that relief (R. 12). If this Honorable Court should be of the opinion that the amended bill states only a cause of action upon the pledge agreement and if the Court should hold that such agreement is ultra vires and void and may be disaffirmed by the receiver, then your petitioner respectfully asks that such action of the Court be without prejudice to another cause of action by petitioner against the receiver for money had and received or for the recovery of or compensation for the money with which petitioner parted on the faith of the pledge agreement. *Central Transportation Co. v. Pullman's Car Co., 139 U. S. 24, 60, 35 L. ed. 55, 60;*

Pullman's Palace Car Co. v. Central Transportation Co., 171 U. S. 138, 43 L. ed. 108.

This Honorable Court in many decisions has held that even though a contract of a corporation be illegal and void, yet, if the other party thereto has actually performed it, in order to do justice between the parties, the courts will imply an agreement on the part of the corporation to return that which it has received by reason of the unlawful contract. We quote from a few of the leading cases to illustrate the rule:

Central Transportation Co. v. Pullman's Car Co., 139 U. S. at page 60, 35 L. ed. p. 69:

> "A contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms, but on an implied contract of the defendant to return, or, failing to do that, to make compensation for, property or money which it has no right to retain".

Aldrich v. Chemical National Bank, 176 U. S. at page 636, 44 L. ed. p. 618:

> "Suppose a national bank, in violation of the act of Congress, takes as security for a loan made by it a deed of trust of real estate, and subsequently causes the property to be sold and the proceeds applied in payment of its claim against the borrower, a surplus being left in its hands, which it uses in its business or in the discharge of its obligations. If sued by the borrower for the amount of such surplus, could the bank successfully resist payment upon the ground that the statute forbade it to make a loan of money on real estate security? Common honesty requires this question to be answered in the negative".

Citizens' National Bank v. Appleton, 216 U. S. at page 206, 54 L. ed. p. 446. (after quoting from the Pullman Car case, first above cited):

> "We need not go farther. It is entirely clear that the judgment against the defendant bank * * * was consistent with sound legal principles and was intrinsically right, even if the guaranty in question was beyond the power of the guaranteeing bank, under the national banking statutes. Whatever may be said as to the written guaranty, now alleged to be illegal, the judgment can be supported as based wholly on the implied contract, which made it the duty of the Central National Bank, under the facts disclosed, to account to the Cooper Exchange Bank for the money obtained

from the latter in execution of the agreement made by the former with the borrower".

Although holding that this is not a suit for benefits (R. 125), the Circuit Court of Appeals in effect has held that the bank received no benefits which may be recovered. This it accomplished by finding and concluding that the contract of deposit contained two agreements, viz: "One that the bank should pay back to the railway upon demand the sums deposited with it as other general deposits were. * * * The other is an agreement for security" (R. 124), and by holding that the moneys deposited by the railway company in reliance upon the invalid pledge agreement became general deposits the title to which ipso facto passed to the bank (R. 124-125).

The relationship between banker and depositor is one voluntarily assumed and must rest upon some contract between the parties. *Ruling Case Law, Vol. 3, p. 518.* Therefore, "whether a deposit in a bank is general or special depends upon the contract resulting from the mutual understanding and intention of the parties at the time such deposit is made". *Northern Sugar Corporation v. Thompson (C. C. A. 8th Circuit), 13 Fed. (2d) at page 831.* This the Circuit Court of Appeals conceded (R. 125), but, citing as authority its opinion in *Fagan v. Whiddon, 57 Fed. (2d) 631,* the

Court held "an agreement definitely fixing the character of the deposit as general may not be disregarded because, if the depositor had fully known the law and the facts, he would have acted differently for his protection" (R. 125). In that case the executors of Whiddon sought to impress certain funds in the hands of Fagan, receiver of the First National Bank of Avon Park, Florida, with a trust to the extent of Whiddon's savings deposits in that bank. After making the deposits, which the Court stated created the relationship of debtor and creditor, Whiddon was adjudged insane and his guardians, later his executors, "undertook to ascertain the nature and condition of the accounts and business of their award with the bank, the deposits that he had there and the property they held for him, and made general and specific inquiries of the officers of the bank; they sought and obtained an inventory and specifically inquired whether Whiddon had a savings account" (p. 631). The inventory furnished showed no savings account, and "the officer to whom the inquiry was referred, having full knowledge that his statement was false, advised that Whiddon had no savings account" (p. 631). After Whiddon's death, his executors relied upon the statements and representations of the bank's officer that Whiddon carried no savings account in the bank, and they did not ascertain that he had one until the bank had been placed in the

hands of a receiver. Had they known of the existence of the savings account, Whiddon's executors would have withdrawn the money before the bank failed (p. 631). After finding these facts the master, to whom the case was referred, concluded that,—

> "since the result of the fraudulent acts and concealments of the bank and its officers, if given effect to, would be in effect to permit the bank to tender a now insolvent for a then solvent debtor, and thus defraud appellees of the moneys they would then have received, the matter must be looked on as though the deposit had in fact been withdrawn, the relation of debtor and creditor terminated, and a new relation of trustee for a special fund created" (pp. 631-632).

The judgment of the District Court, adopting the master's conclusions of law, was reversed by the Circuit Court of Appeals, with directions to dismiss the bill. In support of its decision, the latter Court stated:

> "All that has occurred here is that a debtor bank has put off payment of its debt until it has become unable to pay it, by falsely stating to the representatives of the depositor that the debt did not exist. False and reprehensible though this conduct was, and liable as its authors undoubtedly are for the damage which it caused, its factual and legal character and consequences cannot, be-

> cause insolvency has ensued, by any kind of equitable intendment be converted from the false statement that the debt did not exist, into the true statement that it did, and an agreement that it would be regarded as withdrawn as a general and redeposited as a special deposit to be held by the bank not as its own money, for the amount of which it stands debtor to the depositor, but as the depositor's money of which it is trustee" (p. 632).

In the Whiddon case, the character of the deposits when made was definitely fixed as general, about which no controversy arose, and the novation in law which the executors sought to establish arose out of circumstances occuring after the deposits were made. In the case at bar the character of the deposits depends upon an agreement antedating or contemporaneous with the deposits by which the Texas and Pacific agreed that they might be general provided they were secured. This is made clear by the District Court's findings of fact that the president of the railway company informed the bank's vice president-cashier "that under no circumstances would The Texas and Pacific Railway Company continue its account with and deposits in the First National Bank of El Paso without full and adequate security" (R. 90), and that the railway company, believing the representations of the bank's officers and attorneys that the pledge agreement and liberty bonds "would protect the deposits of The Texas and Pacific Railway Company in The First

National Bank of El Paso as fully and to the same extent as said corporate bonds", accepted the pledge agreement and those bonds, cancelled the surety bonds and thereafter continued its account with and made deposits in the First National Bank "relying upon said pledge agreement and liberty bonds as security for its deposits" (R. 92-93). To hold otherwise would mean that the railway company agreed to place its moneys in the First National Bank as general deposits even though the pledge agreement was invalid. Such is contrary to the record in this case.

In support of its position that the Texas and Pacific placed its moneys on general deposit, the Circuit Court of Appeals declared that the railway company "was as fully charged with knowledge as the bank was" of the latter's "want of power" to make the contract for security (R. 125). This conclusion, of course, is predicated upon the Court's prior finding that national banks can only exercise those implied powers which are "necessary (that is, indispensable) to the proper conduct of the business of a national bank" (R. 124). This, as we have shown in the preceding section of this brief, is not the proper measure of the implied powers of national banks. Those banks are expressly authorized to exercise all such incidental powers as shall be necessary—that is, convenient or useful[1]—to

1 McCullough v. Maryland, supra, pages 42-44.

carry on the business of the bank, and what may be convenient or useful to it is purely a fact question peculiarly within the knowledge of the bank's officers. Moreover, "the mutual understanding and intention of the parties," *Northern Sugar Corporation v. Thompson*, supra, not the legal knowledge of the depositor, determines the character of the deposit, and since the Texas and Pacific required the bank to furnish corporate surety bonds for more than eight years and made it plain to the bank's officers when the pledge agreement was made that the railway company's account would be closed and its deposits withdrawn if they were not fully secured, it cannot be successfully contended that it was the mutual understanding and intention of the bank and the railway company that the title to the latter's deposits should vest in the bank if in fact the pledge agreement was void.

After January 29, 1931, when the liberty bonds were substituted for the surety bonds as security for its deposits, The Texas and Pacific Railway Company continued its account with and thereafter deposited in the First National Bank a total of $148,765.75 (R. 93), and at all times between January 29, 1931 and September 4, 1931, when the bank failed, the Texas and Pacific had an amount in excess of $50,000 on deposit (R. 47, 67, 81). At the close of the bank's business on August 6, 1931, the railway company had a balance of

$50,428.10, and it deposited an additional $16,545.48 between August 6 and September 3, 1931 (R. 84, 93). On the latter date the T as and Pacific had $54,325.90 in the bank to which sum was added a small interest payment and an unpaid cashier's check, thus raising the total to $54,646.94 as of September 4, 1931 (R. 84-85, 93). All of those funds were deposited subsequent to January 29, 1931, the date on which the liberty bonds were substituted as security for the Texas and Pacific's deposits (R. 93), and the so-called "assets" of which the receiver took charge on September 8, 1931 (R. 48) included those funds.

It is true that the receiver is directed by section 192 of the National Bank Act to take charge of all the bank's "assets" etc. and to pay over to the Treasurer of the United States, subject to the order of the Comptroller, all moneys received from the collection of debts, claims, and the sale of property, and the Comptroller by section 194 is directed to make a "ratable dividend" from time to time, under certain conditions, of the moneys turned over to him by the receiver, but this Honorable Court has held that "the requirement as to ratable dividends, is to make them from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank" *Scott v. Armstrong, 146 U. S. at page 510, 36 L. ed. p. 1063.*

There is another aspect of this case which should not be overlooked. It is of record that the bank's vice president-cashier, who succeeded in getting the railway company to accept the pledge agreement and the liberty bonds in lieu of the corporate surety bonds, knew at the time he came to Dallas for that purpose that the Maryland Casualty Company, surety on one of the $25,000 bonds, intended to "get off" all bonds of the First National Bank; that the bank was "going to have to give up this Maryland Casualty bond"; that the railway company was being asked to accept the liberty bonds in lieu of the surety bonds partly because the bank knew that the Maryland Casualty Company would ask that the bond be canceled, or would not renew it; and that it was doubtful whether or not the bank could get a substitute standard surety company. But that bank official "did not mention" to the railway company's president "at the time this substitution was made, nor at any time thereafter, this substitution was desired on account of the surety company threatening to cancel its bonds. He never heard of that, so far as I know" (R. 63, 70-72). Had a full disclosure been made, the railway company would not have agreed to the cancellation of its surety bonds. Having obtained the railway company's deposits under these circumstances, which give rise to a constructive fraud, the Court should hold that the bank received them

as special deposits the title to which remained and now is in the railway company.

Since the First National Bank, if the pledge agreement be void, received the Texas and Pacific's deposits not as general but as special deposits, they never became the property of the bank which the receiver might distribute ratably to unsecured creditors, but the receiver took them as a part of the funds passing into his hands impressed with a trust in favor of the railway company.

Conclusion

As stated by Attorney General Gregory, "the power to receive deposits, expressly granted to every national bank * * * is, of course, indispensable to the conduct of banking, and the extent of its exercise is in a degree the measure of the success of the bank"; "the means by which depositors are to be protected and secured are not expressly limited or restricted by statute"; "a large discretion is left to the (bank's) officers and directors"; and "they may use such means for the purpose as are not prohibited by, or inconsistent with the provisions of, the law, and as they may reasonably find to be suitable and proper and not inconsistent with the prudent conduct of the affairs of the bank within the scope of its charter"[1]. That officers and directors of banks have availed themselves of this privilege is shown by the finding of the Supreme Court of Tennessee that the practice of giving security for deposits "is a practice followed by many banks", *Grigsby v. Peoples Bank, 158 Tenn. 193.*

The officers and directors of The First National Bank of El Paso, Texas, considered the exercise of that prerogative beneficial to the bank as shown by this record: Although admittedly solvent (R. 89), it became necessary for the First National to curtail expenses, including the premiums which it had been paying on the

1 Supra, pages 47-49.

surety bonds protecting the railway company's deposits (R. 64). In addition the Maryland Casualty Company, surety on one of those $25,000 bonds, had informed the officers of the bank that it was "going off" all bonds, and it was apparent the bank would experience difficulty in procuring a substitute surety company (R. 70-72). The bank's officers knew that the railway company with the cancellation of its bonds would close its account and withdraw its deposits (R. 90), and this they wished to avoid. They proffered to the Texas and Pacific a pledge of liberty bonds in lieu of the corporate surety bonds (R. 89), and, being unaware of the action of the Maryland Casualty Company the railway company, solely for the purpose of aiding the bank (R. 90), accepted the pledged liberty bonds, caused the surety bonds to be cancelled (R. 92-93), continued its account with the First National and thereafter deposited with it a total of $148,765.75 (R. 93).

This being true, we confidently believe this Honorable Court will find and hold (1) that the pledge of liberty bonds in lieu of the surety bonds as security for the railway company's deposits was a valid exercise by the First National Bank of a power incidental to its express power to receive deposits, (2) that the receiver may not disaffirm such pledge agreement, at least without returning or tendering to the Texas and

Pacific the full amount of its deposits made in reliance upon that agreement, and (3), in the alternative, that the railway company may recover from the receiver, as for money had and received which he holds in trust, the full amount of its deposits when the bank failed on September 4, 1931.

Wherefore, petitioner respectfully prays that this Honorable Court reverse the decree and judgment of the District Court and the Honorable Circuit Court of Appeals for the Fifth Circuit and remand this cause with direction to grant the relief sought by petitioner, that costs be taxed against respondent, and that such other orders and decrees be entered as to this Honorable Court petitioner may seem entitled in the premises.

Dated at Dallas, Texas, November 20, 1933.

Respectfully submitted,

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